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SUBJECT: KAESONG INDUSTRIAL COMPLEX: THE INTER-KOREAN
PROJECT TO WATCH

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SUMMARY

[1](#)1. (C) The Kaesong Industrial Complex (KIC), a tidy enclave where 24 South Korean companies employ almost 16,000 North Korean workers on DPRK soil, is the most tangible and significant aspect of North-South relations. By our calculation using parallel market exchange rates, the North Korean government keeps as much as USD 56 out of the 58 USD monthly salary for each worker. Exploitation? Of course. But even that USD 2 salary and benefits associated with working in KIC are better than the employment benefits for most North Koreans. More important, however, is KIC's potential for educating an expanding slice of the North Korean workforce about free markets and, over time, about open societies. Developer Hyundai Asan envisions a Manhattan-sized complex and city housing 2,800 companies, employing 350,000 workers, and producing USD 20 billion in goods per year by 2020 -- not to mention two golf courses and an amusement park. That vision is part hype; initial development has moved more slowly than projected. Nonetheless, the expansion plan is backed by substantial investment in infrastructure and high-level ROKG support. Prospects are that KIC will send an increasingly powerful message to the North Korean population about the benefits of South Korean-style free markets and the superiority of South Korean society. END SUMMARY.

KIC WAGES

[1](#)2. (C) The ROK initially believed that North Korean workers at KIC would get their salaries directly each month (ref A), but that has not turned out to be the case. Instead, USD payments from ROK employers to North Korean authorities at KIC amount to a significant hard currency source for the DPRK, probably close to USD 900,000 per month, as explained during our June 21 visit to KIC (ref B).

13. (C) Kim Dong-un, a South Korean who is Chairman of the Korean Industrial District Management Committee, and who now lives at KIC, and Hyundai Asan Vice President Jang Whan-bin, who has managed the details of this Hyundai Asan-led project since its early days, said that South Korean companies make a monthly cash payment of USD 58 per worker (more if overtime is paid) to the DPRK's Central Special Direct General Bureau at KIC. The DPRK then deducts 30 percent of wages, or USD 17.40 for social insurance and other benefits, leaving USD 40.60. But the North Korean workers never see U.S. dollars. Of the remaining USD 40.60, 80 percent or 4,547 NK won is credited to workers' accounts at special public distribution centers in Kaesong City. Kim said he had visited the distribution centers -- he goes to Kaesong City several times a month after giving advance notice of his plans -- and had seen that they were stocked with "food, clothes and shoes." Another 20 percent or 1,261 NK won is paid to workers in cash, for a total wage of NK won 5,684, using the official exchange rate of 140 NK won/USD.

14. (C) The black-market value of the USD in North Korea -- which Canadian diplomats who traveled to Pyongyang in June reported was 2,800 NK won/USD -- is relevant here, because it means that the DPRK authorities can provide NK won 5,684 worth of goods and cash for the equivalent of about USD 2.00.

Hence, DPRK authorities could be seen as netting about USD 56.00 per worker per month (USD 58.00 minus the USD 2.00 value of consumer goods and NK-won cash paid to workers), or USD 870,000 per month for the North Korean workforce of 15,579 (leaving aside any costs for social insurance and benefits that the DPRK incurs). Still, the wages that North Korean workers get at KIC are significantly higher than what production workers are believed to receive elsewhere in North Korea. Under North Korea's centrally planned economy, remuneration is primarily in kind rather than in cash, and prices for basic necessities are set artificially low. Kaesong workers therefore probably have considerably greater disposable purchasing power than most of their compatriots. They also have the additional benefits of certain meals provided on site, hot showers, and the ability to do laundry, Kim said.

WORKER ATTITUDES

15. (C) Asked to characterize the North Korean workers, Kim replied that the workers are "educated, diligent, and expect a better life." As we toured the KIC facilities and ate lunch at the Hyundai Asan cafeteria, he noted that KIC's workforce now includes representatives from about one-third of Kaesong City's 55,000 households (apparently limited to one worker per family), so people had to be talking about it among themselves. Some workers had also told him, quietly, that "the market economy is better," but he added that the workers were required to attend two-to-three hours of ideological training in Kaesong City on Saturday afternoons (anecdotally said to be standard across much of North Korea).

He added that North Korean authorities were initially concerned that South Korean companies would try to influence the workers, perhaps talking to them about democratic values, but the North Koreans had relaxed after they realized that the companies were only interested in profits.

MORE CAUTIOUS VIEWS

16. (C) Walter Paik, an advisor to Grand National Party (GNP) Presidential contender Park Geun-hye, told us on June 29 that the GNP supported KIC as a "capitalist project" that could "blow the winds of democracy and market economics" into North Korea. He offered, however, two caveats: that GNP would want to slow down expansion of KIC (along with South Korean tourism to Mt. Kumgang in North Korea) until Pyongyang showed signs of change. He argued that the level of trust between the North and South was too low, and that it was absurd that KIC workers did not receive their wages directly. He said

Hyundai Asan's projections for KIC's growth were overblown because South Korean companies would prefer to seek low wages in places like Vietnam and Cambodia rather than put up with political uncertainty at KIC.

¶7. (SBU) At a June 14 Seoul dinner in honor of former ROK President Kim Dae-jung, long-time North Korea watcher Leon Sigal, now director of the Northeast Asia Cooperative Security Project at the Social Science Research Council in New York, told the audience that he had visited KIC for the first time the previous day and found its existence amazing. But he said he also came away with questions about its future. For example, if a North Korean worker were severely injured at KIC, would he or she be taken to a North or South Korean hospital? Similarly, would a major fire bring a response from a fire department in the South? He also said that there were more general unanswered questions, such as whether KIC was teaching workers about markets and democracy, or just about the process of acquiring goods. We later posed the injury and fire questions to Kim Dong-un. He said doctors at KIC would treat all injuries, but they were not expected to be serious because KIC focused on light manufacturing, and the KIC's fire department would handle all fires. Kim sidestepped a question about when KIC would be open to internet communication, so that a potential investor could count on being able to do research and development, answering that KIC would be sure to supply workers who were qualified for investors' needs.

INFRASTRUCTURE BUILT, INCREASING PRODUCTION,
AND AMBITIOUS PLANS

¶8. (C) While those questions about KIC's future remain, the infrastructure -- electricity, eight-lane roads, water supply and treatment -- is in place for a major expansion. (NOTE: The ROK Ministry of Commerce, Industry and Energy on June 21 announced the dedication of a substation in Kaesong that can receive 100,000 kilowatts of electricity, enough to serve up to 30,000 households, from the South via 154-kilowatt power cables across the DMZ. END NOTE). KIC statistics also show labor productivity increasing. Hyundai Asan's presentation during our June 21 visit depicted workers' rising productivity since KIC's initial factory hired the first 255 workers in December 2004; now it is at 85 percent of South Korean workers' levels, or "on par with South Korean workers," according to Jang. Monthly production per worker was USD 230 in January 2005 but rose to USD 1250 as of June ¶2007. Exports quintupled from USD 2.3 million during January-April 2006 to USD 11.3 million during January-April ¶2007.

¶9. (C) Jang said that North Korean authorities wanted rapid expansion of KIC, but their "tug-of-war" on operational details clashed with that enthusiasm. For example, DPRK authorities had only recently agreed to allow vehicles to transit the DMZ every half hour, or 23 times per day. That had helped relieve congestion, but it had taken too long to get to that point. Another frustration was that the Hyundai-Asan-built KIC train station, complete with a large portrait of Kim Il-sung, was only a stone's throw away from the gates of the KIC but had not been used except for the ceremonial border-crossing on May 17. Hyundai Asan would also like trains to transport workers to and from Kaesong City. Wider political conditions played a role too: Hyundai Asan had planned to launch the new 1.25 square mile Phase I area, expected to house 300 firms employing 70,000 workers, by the fall of 2006: but the DPRK's missile and nuclear weapon tests had forced a delay. Now the area was still waiting for the next set of factories to be built. Jang noted with pride, however, that when the first 150 factory sites were made available for applications from May 28 to June 5, 356 companies had applied including seven existing companies planning to expand operations.

¶10. (C) Deputy Foreign Minister Shim Yoon-joe told us on June 22 that KIC's real impact would come when the workforce

increased to the point that North Korean authorities needed to draw on labor from beyond Kaesong City -- not only because of the greater number of individuals affected, but also because transportation systems and living quarters would have to be improved. News reports suggest that the DPRK is already planning to send up to 3,000 workers to KIC from Pyongyang.

COMMENT: KIC IS THE ENGAGEMENT PROJECT TO WATCH

11. (C) On the downside, KIC is clearly a source of hard currency for the DPRK, raising questions about how it uses these funds. At the same time, KIC, especially as it continues to expand, sends a powerful message to North Koreans -- directly to workers and indirectly to many others -- about a market economy, much more powerfully than any rhetoric. Since the ROK has virtually no other means of demonstrating market economics on a daily basis on North Korean soil, we believe this demonstration effect and the influence it exerts outweigh concerns about the misuse of funds. We agree a workforce expansion could have wide-reaching effects on the DPRK. KIC's growth would be an unmistakable rebuke to the North's command economy, the results of which are visible outside the KIC fence in the form of hollowed-out buildings without windows or electricity and farm laborers plowing the soil by hand. If the KIC did not exist, and the possibility arose for several thousand North Korean workers to be transported to the South for one day to see ROK manufacturing in action, we would jump at the chance to give those workers a glimpse of the outside world. The KIC may be the camel's nose under the tent.

STANTON